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DEALING WITH CORPORATE MISCONDUCT

*Peter J. Henning**

“Luck is the residue of design.” Branch Rickey

The standard method these days to resolve a criminal investigation of a corporation, particularly those with publicly traded shares, is a deferred or non-prosecution agreement.¹ Under such agreements, the company generally pays a fine, some of which have been quite hefty, and perhaps submit to outside monitoring. Upon announcement of the resolution of the case, a company can be expected to issue a contrite public statement committing itself to making a greater effort toward future compliance with the law. For particularly severe or high-profile cases, such as when the Department of Justice wants to show how tough it is on crime, a guilty plea by the organization may be required. Finally, prosecutors may require a company to alter its internal governance structure, perhaps by splitting the jobs of chief executive and chair of the board of directors or creating new reporting lines within the organization.

One might think this approach to corporate criminality is the product of rational decision-making based on a carefully weighing of the benefits of a criminal sanction versus the costs imputed to shareholders as a result of the penalties and expenses of complying with any edicts for future conduct. But that is not the case. Instead, the proliferation of deferred and non-prosecution agreements, designed to spare a company from a criminal conviction along with its collateral consequences, has been largely a reaction to the demise of accounting firm Arthur Andersen following its conviction for obstruction of justice regarding how it responded to the burgeoning accounting scandal at Enron.² The growth and development of deferred and non-prosecution agreements since then has been haphazard, with federal and state prosecutors employing a variety of terms in the agreements to achieve different goals, from enhancing internal controls and strengthening compliance programs to ousting a chief executive. It is clear that there is no articulable plan for how corporate violations should be punished much beyond avoiding the “Arthur Andersen effect,”³ and

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1. See Rachel E. Barkow, *The New Policing of Business Crime*, 37 SEATTLE U. L. REV. 435, 439 (2014) (“The Department of Justice (DOJ)—the United States’ chief prosecutor of financial crimes—is taking a more active role for itself inside companies, at least for those companies that have already demonstrated a propensity for wrongdoing. DOJ increasingly allows companies to enter deferred prosecution agreements (DPAs) or non-prosecution agreements (NPAs) that allow companies to avoid criminal charges if they agree to terms set by prosecutors.”).

2. See *Arthur Andersen LLP v. United States*, 544 U.S. 696, 698 (2005). The Supreme Court’s subsequent reversal of the conviction came far too late to save the firm, which went out of business shortly after its conviction.

3. See Peter J. Henning, *Seeking Guilty Pleas From Corporations While Limiting the Fallout*, N.Y. TIMES DealBook(May 5, 2014, 1:20 PM),

prosecutors have not determined what combination of sanctions and rehabilitative programs should be implemented when a corporation engages in criminal conduct.

It is easy to criticize deferred and non-prosecution agreements for injecting ill-trained federal prosecutors into corporate boardrooms,⁴ but those critiques have had no real impact on the practices followed by the Department of Justice in resolving cases. Instead, Professor Lawrence A. Cunningham offers a way to make these agreements a more effective tool, which calls for prosecutors to take a disciplined approach to deciding what should be required of a company to resolve a case that is more than just the “flavor of the week” approach to the terms. His article, *Deferred Prosecutions and Corporate Governance: An Integrated Approach to Investigation and Reform*,⁵ offers an elegant approach—not a solution—to making these agreements an effective tool of law enforcement when the government wants to impose corporate governance changes on a defendant.

Professor Cunningham recommends that prosecutors undertake an *ex ante* assessment of a company’s governance profile when it is the target of an investigation to determine whether the organization needs to adjust how it operates.⁶ If a measure of organizational restructuring will be required by an agreement to resolve the investigation, then the government should make clear the rationale for demanding those particular changes. Otherwise, we are left with agreements that “can seem like ad hoc ransoms or trophies created on the fly by prosecutors seeking to claim victory.”⁷

This integrated approach is elegant in the sense that it is concise and simple, addressing the reality of how the government will resolve cases without dawdling over whether deferred and non-prosecution agreements are the best or most efficient means available for redressing corporate misconduct or whether civil sanctions work best. It is a flexible approach in that it does not offer particular terms that should be imposed as part of any settlement, nor does it demand that the government renounce certain remedies in the name of protecting directorial or managerial control over the enterprise. Instead, the starting point is for prosecutors to determine how a company’s culture has developed, and then identify its strengths and shortcomings in an effort to redress not only a particular violation but to develop a means to prevent future misconduct. The goal is *not* to impinge

<http://dealbook.nytimes.com/2014/05/05/seeking-guilty-pleas-from-corporations-while-limiting-the-fallout/>.

4. See generally, e.g., PROSECUTORS IN THE BOARDROOM: USING CRIMINAL LAW TO REGULATE CORPORATE CONDUCT (Anthony S. Barkow & Rachel E. Barkow eds., 2011) (compiling a series of articles to evaluate deferred prosecution agreements in the post-Andersen economy).

5. Lawrence A. Cunningham, *Deferred Prosecutions and Corporate Governance: An Integrated Approach to Investigation and Reform*, 66 FLA. L. REV. 1 (2014).

6. *Id.* at 3.

7. *Id.*

on prosecutorial discretion,⁸ a problem that arises with any solution seeking to dictate how the Department of Justice ought to resolve a case, such as whether a civil settlement would achieve the same goals as a criminal case.

I see two interrelated concerns with Professor Cunningham's integrated approach to resolving cases of corporate misconduct when an agreement may require changes in corporate governance. Neither presents an argument against what he proposes, but rather potential roadblocks that could make implementation more difficult. The first concern arises from the proposed *ex ante* investigation of a company's governance structure. As the article points out, there will be increased costs with this analysis, including the need for expert assistance in assessing where changes in corporate governance can be made and a second team of prosecutors to determine the terms of any settlement that might include such changes.⁹ But those costs are not a significant hurdle, as he notes, and the learning curve to understanding how a company operates would not be too steep.¹⁰ There is, however, another more problematic issue with conducting this type of parallel investigation that could undermine the efficacy of the inquiry. There are few limits to what a federal grand jury can obtain, as the Supreme Court highlighted in *Branzburg v. Hayes* when it stated that grand jurors have the "right to every man's evidence."¹¹ Companies may be uneasy or, indeed, alarmed by the prospect of federal prosecutors rummaging through their records looking for weaknesses in the governance apparatus—perhaps out of fear that the Department of Justice will find new violations, but also simply because they do not want prosecutors intrusively searching through everything the organization does.

To better illustrate this point, examine a moment the compliance defense sought for corporations when the government is considering a charge of violating the Foreign Corrupt Practices Act. The argument in favor of the defense is that the company should not be held liable if it has in place an effective compliance program designed to prevent and detect violations involving overseas bribery.¹² I pointed out that one potential

8. *Id.* at 49 ("The integrated approach to DPAs is drawn narrowly to minimize infringement on prosecutorial discretion.").

9. *Id.* at 57–58.

10. I highly recommend that federal prosecutors familiarize themselves with Professor Cunningham's book for insight into how corporations structure their financial and internal control structures. LAWRENCE A. CUNNINGHAM, *INTRODUCTORY ACCOUNTING, FINANCE AND AUDITING FOR LAWYERS* (6th ed. 2013).

11. 408 U.S. 665, 688 (1972) ("the longstanding principle that 'the public . . . has a right to every man's evidence,' except for those persons protected by a constitutional, common-law, or statutory privilege is particularly applicable to grand jury proceedings.") (citation omitted).

12. See ANDREW WEISSMANN & ALIXANDRA SMITH, U.S. CHAMBER OF COMMERCE, INSTITUTE FOR LEGAL REFORM, *RESTORING BALANCE: PROPOSED AMENDMENTS TO THE FOREIGN CORRUPT PRACTICES ACT 11* (2010), available at <http://www.instituteforlegalreform.com/resource/restoring-balance>.

downside to this type of protection is that it might “encourag[e] prosecutors to scour a company’s records for evidence to undermine the claim that its program meets the requirements for being determined an ‘effective’ one.”¹³ That same concern may apply if the government seeks to review documents and interview executives about how a company is governed before it will agree to a deferred or non-prosecution agreement because it can be viewed as yet another intrusion by the government. Moreover, what limits would be placed on this parallel investigation?

That leads to a second related concern regarding how Professor Cunningham’s approach would be implemented. His analysis requires two willing participants in the process, at least to the extent the government cannot merely extract information through grand jury subpoenas to identify potential internal corporate governance issues. The approach seems to rest on the assumption that companies will welcome prosecutors inquiring into their governance and respond favorably to proposed terms that impose changes based on the *ex ante* investigation. I wonder whether the targets of corporate criminal investigations might prefer the current system that merely imposes some additional costs beyond the fines from a settlement, such as the appointment of an outside monitor, beefed up compliance procedures, restrictions on a line of business, or enhancing internal controls over certain types of expenditures. No corporation wants to spend more money, but to the extent the company can continue to operate as it always has, with little outside interference or oversight, then an agreement with the government that does not involve any significant governance changes might be preferable over running the risk that the *ex ante* inquiry will turn up even more problems.

Under the current regime, once the Department of Justice investigation is resolved, along with any parallel civil inquiry, there is usually little outside interference with the company’s operations going forward. Shareholder lawsuits are largely ineffective as a means of policing corporate compliance programs, even with the *Caremark* duty imposed on corporate directors.¹⁴ Federal prosecutors and regulators move on to the next case after reaching a deferred or non-prosecution agreement and a civil settlement. Because some companies enter into multiple agreements, there is little threat of additional punishment for recidivists.¹⁵ Judges sign off on the agreements with little additional scrutiny, a position recently

balance-proposed-amendments-to-the-foreign-corrupt-practices-act/.

13. Peter J. Henning, *Be Careful What You Wish for: Thoughts on A Compliance Defense Under the Foreign Corrupt Practices Act*, 73 OHIO ST. L.J. 883, 926 (2012).

14. *In re Caremark Int’l Inc. Derivative Litig.*, 698 A.2d 959, 967 (Del. Ch. 1996); see Cunningham, *supra* note 5, at 15 (“The importance of effective compliance programs became more central to corporate life after 1996 when the Delaware Court of Chancery in *Caremark* announced clear compliance duties of corporate directors.”).

15. See Brandon L. Garrett, *Rehabilitating Corporations*, 66 FLA. L. REV. F. 1, 3 (2014) (“Examples of recidivist corporations do not offer comfort.”).

endorsed by the Second Circuit for civil settlements.¹⁶ Although one criticism of these agreements is that they inject ill-trained prosecutors into the corporate boardroom, there appears to be little notable interference with how companies operate, apart from the occasional flare-up—like the insistence of then-New York Attorney General Eliot Spitzer that American International Group (AIG) dismiss its chief executive, which led to a disastrous outcome for the company and the broader economy, as Professor Cunningham well illustrates.¹⁷ Even the AIG removal looks like an isolated instance, however, as few executives have been removed from their position since then at the government's behest.

If the government conducts a thorough investigation of corporate governance and publicly describes why it has sought the particular terms of an agreement, much of that information could be open to outside scrutiny: whether it be through Freedom of Information Act requests, discovery in shareholder derivative suits, or just leaks to the media, it is almost inevitable that some—or perhaps all—of the information gathered in the government's parallel investigation of corporate governance will come out. While not necessarily detrimental to a company, especially one that is well run, there are many organizations that would prefer to keep their dirty laundry in the basement, shielded from outside inquiry. In the end, companies may embrace the status quo embodied in deferred and non-prosecution agreements as they are currently imposed just as much as the Department of Justice, which can use them to generate headlines in resolving an investigation into organizational misconduct without generating any real change in corporate governance.

These criticisms do not mean that the *ex ante* investigative approach is wrong or misguided. In fact, it is the exact opposite. It would add some much needed structure to how prosecutors investigate a company and then craft a resolution to address, not only the particular violation, but more broadly how the company can be reformed to prevent future misconduct. When an agreement seeks to implement real change in corporate governance, it should be, to adapt Branch Rickey's phrase, the result of Professor Cunningham's design rather than just plain luck.

16. See *S.E.C. v. Citigroup Global Markets, Inc.*, 752 F.3d 285, 297 (2d Cir. 2014) (“To the extent the district court withheld approval of the consent decree on the ground that it believed the S.E.C. failed to bring the proper charges against Citigroup, that constituted an abuse of discretion.”).

17. Cunningham, *supra* note 5, at 39–40 (“The governance prescriptions clearly had a causal role in AIG’s near destruction.”).